In the Supreme Court

OF THE

United States

OCTOBER TERM, 1945

No.

ESTATE OF ETHEL M. DUVAL, Deceased, by Thomas M. Robinson, Jr., and Weston Shattuck Robinson, as Executors of her Last Will and Testament,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION.

ACTION BELOW.

An order of deficiency against petitioners was entered by the Tax Court of the United States on February 3, 1945. (R. 30.) The Tax Court's opinion (R. 25-30) is reported in 4 T. C. 722. The judgment of the United States Circuit Court of Appeals for the Ninth Circuit, affirming the Tax Court, was entered on November 24, 1945. (R. 80.) Its opinion was filed on the same day (R. 76-80) and is reported in 152 F. (2d) 103. A petition for rehearing was filed on December 21, 1945, and an order denying same was entered on December 26, 1945. (R. 81.)

JURISDICTION.

The jurisdiction of the Court is invoked under Section 240 (a) of the Judicial Code as amended.[1] The grounds for invoking such jurisdiction are:

1. The Circuit Court of Appeals held that rights over against the corporate maker and the co-guarantor existed, under the law of the State of California, in decedent's favor at the time of her death, and thereby decided an important question of California law directly contrary thereto.

2. The Circuit Court of Appeals failed to give proper effect to the decisions of the United States Supreme Court that state law creates legal interests and rights and the federal revenue acts designate what interests or rights so created shall be taxed, both by holding that such rights over did so exist and by holding further that, even if such rights over did not so exist, the principle of uniformity of taxation operated to establish them for federal estate tax purposes.

3. Even assuming that such rights over did so exist, the Circuit Court of Appeals erred in failing to value them by the formula established in the Internal Revenue Code and the Regulations thereunder. There is a conflict in the decisions as to the method of valuing such

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[1] 28 USCA § 347. "* * * (a) In any case, civil or criminal, in a Circuit Court of Appeals, or in the United States Court of Appeals for the District of Columbia, it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, whether Government or other litigant, to require by certiorari, either before or after a judgment or decree, by such lower Court, that the cause be certified to the Supreme Court for determination by it with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted appeal."

rights over, and the method followed by the Circuit Court of Appeals was not the proper one.

STATEMENT OF FACTS.

Ethel M. DuVal, called the decedent, died testate on April 9, 1942, and at the time of her death was a resident of Alameda County, California. The petitioners, Thomas M. Robinson, Jr., and Weston Shattuck Robinson, are the duly qualified and acting executors of the decedent's will which was admitted to probate by the Superior Court of Alameda County. (R. 21.)

Mrs. DuVal and her sister, Mary J. Robinson, called the co-guarantor, were officers and shareholders of the M. K. Blake Estate Company, called the corporate maker, which on August 17, 1936 and November 2, 1941, borrowed from the Bank of America, National Trust and Savings Association of Oakland, California, called the bank, the sums of $162,000 and $20,000, respectively. The sums borrowed were evidenced by the corporate maker's note and were secured by a deed of trust on its realty. (R. 21-23.)

The bank also required the decedent and the co-guarantor to endorse and guarantee these notes, which they did. Each note contained a waiver of presentment, demand, protest, notice of protest and notice of nonpayment.[2] The note for $20,000 contained also a waiver of

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[2] "For Value Received, I hereby guarantee payment of the within obligation and all renewals or extensions thereof and I hereby waive presentment, demand, protest, notice of protest and notice of payment." (R. 22.)

the rights to benefit from any security until the indebtedness had been paid and to require any remedy other than a proceeding directly against the guarantors.[3] (R. 21-23.) Each note was absolute and unconditional, pursuant both to statute[4] and to the waivers indicated.[5]

On August 26, 1941, the corporate maker and the bank joined in an agreement extending the maturity date of the note for $162,000 to August 2, 1944, and the decedent and the co-guarantor gave their written consent to this extension. The note for $20,000 was, from its inception, to mature on that date. (R. 22-23.)

At the time of the decedent's death, both notes were unpaid in the total amount of $175,000. No part of this amount has been paid since her death. (R. 23.)

After the decedent's death the bank presented its claim for $175,000 against her estate, said claim providing that

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[3]"I also hereby waive (a) the right, if any, to the benefit of or to direct the application of any security hypothecated to the holder until all indebtedness of the maker to the holder, howsoever arising, shall have been paid; (b) the right to require the holder to proceed against the maker, or to pursue any other remedy in the holder's power; and agree that the holder may proceed against the undersigned directly or independently of the maker, and that cessation of liability of the maker for any reason other than payment, any extension, furtherance, change of rate of interest or assistance, release or substitution of security or any impairment or suspension of the holder's remedies or rights against the maker, shall not in anywise affect the liability of the undersigned hereunder." (R. 22-23.)

[4]California Civil Code (Deering, 1941) Sec. 2806. The guarantee of the $162,000 note was made in 1936 *prior* to the 1939 amendment abolishing the distinction between guaranty and suretyship. (See Appendix.)

[5]The guarantee of the $20,000 note was made in 1941 *after* the 1939 amendment *Supra*, note 4. The additional waivers therein relate to the surety benefits of Sections 2846 and 2850 of the California Civil Code.

it was made "by virtue of the guaranty of said deceased of two promissory notes of M. K. Blake Estate Co., a corporation, dated August 17, 1937, and November 2, 1941, respectively." The claim was delivered to the executors in June, 1942 and allowed by them for its full amount in July, 1942. In April, 1943, the claim was approved by a judge of the Superior Court of Alameda County, and in October, 1943, the executors filed with the Court their first account, in which they reported the claim for $175,000 as an allowed and approved claim. This account was approved by order of the Court in November, 1943. (R. 23-24.)

The decedent, by her will, created a residuary trust, naming M. W. Dobrzensky, trustee, for purposes therein outlined. (R. 58-67.) Shortly prior to March 15, 1943, a plan was agreed upon between the executors and the bank whereby the latter agreed to consent to the distribution of the estate to the trustee subject to its claim for $175,000. This plan of distribution still stands and will be carried out. (R. 24, 50-56.)

At the time of the decedent's death, and at all times since, both the corporate maker and the co-guarantor have been solvent. (R. 24-25.) The co-guarantor is an aged person, an invalid and confined to her home.

The executors filed the estate tax return on decedent's estate on April 15, 1943. On February 23, 1944, they were notified by the Commissioner that the deduction of the bank's claim for $175,000 was disallowed, and that a determination of the estate tax liability disclosed a deficiency of $48,214.31. (R. 12-17.) A petition for a redetermination of the deficiency was submitted by the

executors to the Tax Court of the United States. Events subsequent thereto are referred to under ACTION BELOW, supra.

SPECIFICATION OF ERRORS.

Petitioners urge that the Circuit Court of Appeals erred in the following respects:

1. In holding that rights over against the corporate maker and the co-guarantor existed, under the law of the State of California, in favor of the decedent at the time of her death.

2. In holding that "it is of no importance" when such rights over come into existence because "the revenue acts are intended to have a uniform application and to bring into the gross estate what is fundamentally the same in all states, not colored by local characterization."

3. Even assuming that such rights over did exist, under California law, at the time of decedent's death, the Circuit Court of Appeals erred in holding that they might be valued as an asset of the decedent's estate in the full amount of the guaranty claim simply because the corporate maker and the co-guarantor were solvent at the time.

4. In holding that "an absurdity clearly appears" in petitioner's contentions because the estates of numerous co-guarantors might each claim a like deduction.

THE ARGUMENT.*

I.

THE CIRCUIT COURT OF APPEALS HELD THAT RIGHTS OVER AGAINST THE CORPORATE MAKER AND THE CO-GUARANTOR EXISTED, UNDER THE LAW OF THE STATE OF CALIFORNIA, IN DECEDENT'S FAVOR AT THE TIME OF HER DEATH, AND THEREBY DECIDED AN IMPORTANT QUESTION OF CALIFORNIA LAW DIRECTLY CONTRARY THERETO.

In its reasoning on this point, the Circuit Court of Appeals posed, and answered in the affirmative, the questions whether decedent's asserted liability might be deducted from the value of the gross estate under Section 812(b) (3)[6] of the Internal Revenue Code, and, if so, whether the value of decedent's rights over against the corporate maker and the co-guarantor should be included in the gross estate under Section 811[7] of that Code.

Its affirmation that decedent's liability might be deducted from the gross estate included the implicit premise that a deductible claim existed against decedent's estate

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*Italics throughout are supplied, unless otherwise indicated.

[6]I.R.C. (1939), Ch. 3, Estate Tax, Sec. 812(b) (3), 53 (Pt. 1) Stats. 122 (76th Cong. 1st Sess., 1939):

"For the purpose of this tax, the value of the net estate shall be determined * * * *by deducting from the value of the gross estate*—

(b) * * * amounts * * *

(3) *for claims against the estate,*

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as are allowed by the laws of the jurisdiction * * * under which the estate is being administered * * *"

[7]*Id.*, at Sec. 811:

"The value of the gross estate of the decedent shall be determined *by including the value at the time of his death of all property*, real or personal, tangible or intangible, wherever situated * * *

(a) * * * *to the extent of the interest* therein of the decedent *at the time of his death* * * *".

on the contract of guaranty. With this premise petitioners are in accord.[8]

The error of the Circuit Court of Appeals begins rather with its affirmation that since the claim was deductible, then the value of decedent's rights over should be included in the gross estate. For this holds that under California law rights over did exist at decedent's death—a holding directly contrary to California law.

The Circuit Court of Appeals found it sufficient to say that the argument that no rights of contribution, subrogation or reimbursement exist in California until a guarantor actually pays the guaranteed debt was advanced and rejected in the case of *Parrott v. Commis-*

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[8]The claim of $175,000, filed by the bank against decedent's estate was allowed by the executors, and approved and allowed by the California Probate Court. (R. 23-4.) The claim thus became an acknowledged debt of the estate and incontestable as such. (See Sections 707 and 713 of the California Probate Code.) Further, the claim arose out of a business transaction between the bank and the corporate maker, at which time the bank requested the guaranty of decedent. (R. 21.) It is thus supported by consideration (see Section 2792 of the California Civil Code) which flowed to the corporate maker, an immaterial consequence of the transaction. 1 Paul, FEDERAL ESTATE AND GIFT TAXATION (Little, Brown and Company, Boston, 1942), p. 602, § 11.20; *Wragg v. Commissioner* (CCA 1st, 1944), 141 F. (2d) 638 at 639; *Commissioner v. Porter* (CCA 2d, 1937), 92 F.(2d) 426 at 427; *Carney v. Benz* (CCA 1st, 1937), 90 F.(2d) 747. The claim is further based on an absolute and unconditional obligation (Section 2806 of the California Civil Code) of the decedent, and liability of her estate is direct and immediate. Supra, notes 2 and 3. Thus the claim is clearly a "personal obligation of the decedent existing at the time of her death" (Section 81.36 of Regulations 105 (1942)) and so is deductible as allowed by the law of California, the State in which decedent's estate is being probated. Section 812(b)(3) of the Internal Revenue Code, supra, note 6. See Paul, SELECTED STUDIES IN FEDERAL TAXATION (second series, Callaghan and Co., Chicago, 1938), p. 16. See also, Appendix hereto for California statutes cited in this note.

sioner[9], and concluded, citing *Arant on Suretyship*, §§ 73, 75, 79, that:

> "We think the rights over *existing in California* in favor of the person secondarily or primarily liable *become effective* in California *upon payment* of the obligation *as they do in other states.*" (R. 78.)

While the *Parrott* case is readily distinguishable from the situation at hand because the claim there involved was dissipated when the maker of the note paid the obligation during the course of administration of the estate[10], the case is no longer good authority for the Circuit Court of Appeals for the Ninth Circuit, sitting in California, on the broad principle therein stated, and undoubtedly here relied on, that[11]

> "At the time of the death of the testatrix her brother was under contractual obligation—to repay to her any sum that she might pay in excess of one-half of the amount of their joint debt, *and that obligation existed from the date of the execution of the note and mortgage and was property.* Rice v. Southgate, 16 Gray (82 Mass. 142); Griffin v. Long, 96 Ark. 268, 131 S. W. 672, 35 L. R. A. (N. S.) 855, Ann. Cas. 1912B, 622; Norris v. Churchill, 20 Ind. App. 668, 51 N. E. 104."

The *Parrott* case was decided in 1929, prior to the United States Supreme Court's decision in 1937 of *Erie*

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[9]30 F.(2d) 792 (CCA 9th, 1929), cert. den. 279 U.S. 870, 49 S.Ct. 512, 73 L.Ed. 1007.

[10]See *Estate of Parrott* (1926), 199 Cal. 107, 248 Pac. 248, in which the California Supreme Court declined to allow, for inheritance tax purposes, a deduction for that portion of the debt which had been paid during the course of administration of the estate.

[11]*Supra*, note 9, at 793.

Railroad Co. v. Tompkins.[12] The enunciation in the case of general contract and equity principles, *approved in other jurisdictions but in direct conflict with local California law*[13], is an application of the now-discarded doctrine of *Swift v. Tyson.*[14] Such a decision is therefore no longer authority on the question when rights over arise in California because the *Tompkins* case now requires the Circuit Court of Appeals to recognize and apply "local" California law rather than its own notions of "general" law.

The Circuit Court of Appeals' reliance on the statement of general principles by a recognized authority on suretyship is likewise misplaced, for the view therein stated that the *promise* to reimburse, as distinguished

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[12]304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188, 114 A.L.R. 1487 (1937). Concededly the *Tompkins* case was not dealing with an application of a federal revenue statute, but it has been recognized that its principles may be involved in the determination of issues leading up to the federal question at hand. *Page v. Hopie* (CCA 1st, 1939), 104 F.(2d) 918 at 919-20; *Tooley v. Commissioner* (CCA 9th, 1941), 121 F. (2d) 350 at 356. See also McCormick and Hewins "The Collapse of General Law in the Federal Courts" (1938), 38 Ill. Law Rev. 126 at 142; Zengel, "The Effect of Erie Railroad v. Tompkins" (1935), 14 Tul. Law Rev. 1, at 5-6. *But cf.* Note (1941) 55 H.L.R. 255, footnote 2.

[13]Cf. *Rice v. Southgate* (1860), 16 Gray (82 Mass. 142), and *Jackson v. Lacy* (1940), 37 C.A.(2d) 551, 100 P.(2d) 313 (both involving claims against an estate); *Griffin v. Long* (1910), 96 Ark. 268, 131 S.W. 672, and *Yule v. Bishop* (1901), 133 Cal. 574, 65 Pac. 1094 (both involving actions by creditors for debts of corporation); *Norris v. Churchill* (1898), 20 Ind. App. 668, 51 N.E. 104, and *Pacific Freight Lines v. Pioneer Express Co.* (1940), 39 C.A.(2d) 609, 103 P.(2d) 1056 (both involving contributions as between parties jointly liable, one having paid).

[14]16 Pet. 1 (1842).

from the *duty* to reimburse, dates from the original transaction is not adhered to in California.[15]

If the California law on the question of when rights over come into existence were unsettled, or even ambiguous, the complete disregard of California law by the Circuit Court of Appeals might be more understandable. Few propositions of law are better settled in California, however, or have been tested more thoroughly in the crucible of judicial controversy than the proposition that in California there are *no* rights over of *any* kind until a guarantor *actually pays* the guaranteed debt.

Such rights in California do not, as the *Parrott* case and Arant on SURETYSHIP enunciate, exist from the date of the execution of the note, nor are they property interests from that time. They are created only when actual payment is made. Prior thereto, they have no existence of any kind and are not property interests because they are non-existent. The decedent, not having paid the debt, could not therefore have had rights over at the time of her death, nor has the estate acquired such rights during the course of the administration thereof, for payment of the debt has never occurred.

The most recent California decision discussing rights over is a District Court of Appeals case, *Pacific Freight Lines v. Pioneer Express Co.*[16] The problem there involved was one of venue and the determining issue was

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[15]See Arant, SURETYSHIP (West Publishing Co., St. Paul, 1931), page 33, citing and relying on *Rice v. Southgate, supra,* note 13. Cf. *Yule v. Bishop, W. H. Marston Co. v. Fisheries Co.* and *Wills v. Woolner, infra,* note 22. See also *Pacific Freight Lines v. Pioneer Express Co., infra,* note 16, in which a distinction of this kind was termed "• • • pure sophistry • • •".

[16]39 C.A.(2d) 609, 103 P.(2d) 1056 (1940).

where the contract of contribution was made, or where the obligation or liability of contribution arose. The problem of "where" necessarily raised the question of "when" the rights were created. An argument drawing a distinction between the "right to compel contribution" and the "original obligation of contribution" (*compare with the Circuit Court of Appeals' "rights over" and "rights to rights over"*) was made to the Court as follows:

> " * * * We do not question that the *right to compel contribution* does not arise until such time as one of the co-debtors had extinguished the original obligation and paid more than his equal share of it, but * * * the question * * * is * * * where, when, and how did the *original obligation of contribution arise?* * * * The obligation of contribution is created by the relationship of the parties *at the time of the transaction* * * * it remains inchoate until payment * * *"

The Court rejected this argument, saying:

> " * * * *the argument is pure sophistry* * * * The fallacy * * * is at once evident * * *, the right * * * can have no 'inchoate' existence * * * That the right * * * may be partial, and eventually may mature, presupposes a dormant contingent existence of some legal significance, *whereas in truth it has no such distinction under the law* * * * it * * * is founded on principles of equity and natural justice and *comes from the application of principles of equity to the condition in which the parties are found in consequence of some of them, as between themselves, having done more than their share in performing a common obligation* * * * "

By such rejection, this State Court clearly disposed of any distinction in California between "rights over" and

"rights to rights over" and held unequivocally that *nothing* exists prior to actual payment and that venue was therefore had in the county in which such payment occurred. The Circuit Court of Appeals' category of "rights to rights over", as something separate and apart from "rights over", is, in this California Court's words, "pure sophistry".

As uniformly considered, the California courts have regarded rights over in vein similar to that of the *Pacific Freight Lines* case, and have reiterated on occasion after occasion that they *do not exist in any form until actual payment has been made.* Basic throughout is, of course, Section 1432[17] of the California Civil Code which provides that

> "A party to a joint, or joint and several obligation, who *satisfies more than his share* of the claim against all, may require a proportionate contribution from all the parties joined with him."

This California view, admittedly at variance from the general view,[18] found its first expression and application in the "statute of limitations" cases,[19] although it was by no means confined to such situations. Thus, in 1895, in

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[17]Deering (1941), Civil Code of California.

[18]*Supra*, note 13. See also Arant, SURETYSHIP, *supra*, note 15; Arnold, "SURETYSHIP AND GUARANTY" (Callaghan and Company, Chicago (1927), §§ 155, 156 (citing *Rice v. Southgate* and *Griffin v. Long*, *supra*, note 13), and § 177 (citing *Bradley v. Burwell* (1846), 3 Denis (N.Y.) 61, 66). *Cf.* 2 Parsons, CONTRACTS, 8th Ed. 37, quoted from and followed in *Richter v. Henningsam*, *infra*, note 19.

[19]*Sherwood v. Dunbar* (1855), 6 Cal. 53; *Chipman v. Morrill* (1862), 20 Cal. 130; *Richter v. Henningsam* (1895), 110 Cal. 530 at 537, 42 Pac. 1077 at 1079; *Bunker v. Osborn* (1901), 132 Cal. 480, 64 Pac. 853; *Lowenthal v. Coonan* (1902), 135 Cal. 381, 67 Pac. 324; *M. K. McCann Co. v. Denny* (1928), 205 Cal. 147 at 152, 270 Pac. 190 at 192; *Crystal v. Hutton* (1905), 1 Cal. App. 251, 81 Pac. 1115; *Huey v. Patterson* (1918), 37 Cal. App. 335, at 341-42, 174 Pac. 939 at 942.

Richter v. Henningsam,[20] the Supreme Court of California said that

> "a party *acquires a right to contribution as soon as he pays more than his share, but not until then,* and, consequently, the statute of limitations does not begin to run until then * * * "

Later cases did not limit the doctrine of these cases to their narrowest holding, i. e., that the "cause of action accrued" upon payments, thus leaving open the possibility that the rights over were existent prior thereto but simply, as the Circuit Court of Appeals said, "became effective * * * upon payment."[21]

Rather, each factual situation presented the California Courts resulted in a new application and a reaffirmation of the California view that where rights over were concerned, *nothing* existed *prior to actual payment* by the guarantor.

The so-called "stockholders' liability" cases[22] presented the question from the standpoint whether it was the shareholders at the time of the original transaction or the shareholders at the time of the payment of the guaranty claim who were liable to reimburse and contribute to the guarantor. The answer turned upon "when" the rights to reimbursement and contribution came into being. In *Yule v. Bishop,*[23] the Supreme Court of Cali-

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[20] *Supra,* note 19.

[21] *Supra,* page 15.

[22] *Yule v. Bishop* (1901), 133 Cal. 574, 65 Pac. 1094; *Davies v. Torrance* (1922), 188 Cal. 179, 204 Pac. 820; *W. H. Marston Co. v. Fisheries Co.* (1927), 201 Cal. 715 at 724, 258 Pac. 933 at 936; *Wills v. Woolner* (1913), 21 Cal. App. 528, 132 Pac. 283; *Harris v. King* (1931), 113 Cal. App. 357 at 362-64, 298 Pac. 100 at 102-03.

[23] *Supra,* note 22.

fornia, after recognizing that its views did not accord with the general trend in England or in other American jurisdictions said:

> "*In this state,* therefore, it seems to be well settled, both by the language of the Code, and by the decisions of this Court under it, that *full payment* and performance by the surety *extinguishes the primary obligation; that new rights and liabilities then arise* * * * "

The question was presented also where the problem was whether an assignee takes subject to any rights of contribution or subrogation in favor of one who has not paid at the time of the assignment. Since the assignee stood in the shoes of his assignor, he took the assignment subject to whatever duties existed at the time of the assignment and there was thus presented again the question of "when" the rights over arose. In *Arp v. Blake,*[24] the Court held that the rights of contribution and subrogation did not exist at the time of the assignment because payment of the debt had not been made, and hence that the assignee was not liable in an action for contribution or subrogation even though payment was actually made later on by the person claiming the rights over. The Court said

> " * * * *it is not the liability to pay, but an actual payment which raises the right.*"

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[24]63 Cal. App. 362 at 366, 218 Pac. 773 at 775 (1923). Dicta to the effect that the right to contribution is inchoate from the time of the original transaction may be found in this case. In the later case of *Pacific Freight Lines v. Pioneer Express Co., supra,* note 11, this view is expressly rejected; nor is it in accord with controlling California Supreme Court decisions. *Supra,* note 19.

So too, the question was presented where upon the death of a co-guarantor, the other guarantor sought to establish a claim for contribution against the executrix of the estate. In *Jackson v. Lacy*[25] the Court adhered to the rule of law that a right to contribution comes into existence in California only upon payment and applied it to cut off such a claim, saying

> "It is elementary that a party acquires a right of contribution as soon as he pays more than his share *but not until then.*"

Text writers on California law have noted this California view respecting the time when rights over arise. In 23 Cal. Jur., page 941, § 19, it is said regarding subrogation:

> "As a general rule, the doctrine of subrogation requires that the person seeking its benefit must have paid a debt due to a third person, before he can be substituted to that person's right; *it is not a liability to pay, but an actual payment to the creditor which raises the equitable right.*"

In 13 *Cal. Jur.*, page 122, § 30, it is said regarding reimbursement

> "* * * Where the guarantor *pays* the principal obligation he is entitled to reimbursement * * *"

And in 6 *Cal. Jur.*, page 498, § 1, it is said regarding contribution

> "The right to contribute is one which *arises* in favor of an obligor who *discharges more than his just share of a common burden* * * *"

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[25]37 C.A.(2d) 551 at 559-60, 100 P.(2d) 313 at 317 (1940).

It is apparent that the California view that *no* rights over of *any* kind, including rights to rights over, exist until a guarantor *actually pays* the guaranteed debt is well established as a multi-purpose doctrine. It is recited and applied, as shown above, in the situations dealing with (1) venue (2) statute of limitations (3) stockholder's liability (4) assignments and (5) claims against estates. Petitioners submit that it cannot be presumed therefore that for federal estate tax purposes, there was anything in the way of rights over which decedent had at her death which pursuant to California law were rights or property interests. To so hold, as did the Circuit Court of Appeals, was to determine an important question of California law directly contrary thereto. The determination so made was thus clear error.

II.

THE CIRCUIT COURT OF APPEALS FAILED TO GIVE PROPER EFFECT TO THE DECISIONS OF THE UNITED STATES SUPREME COURT THAT STATE LAW CREATES LEGAL INTERESTS AND RIGHTS AND THE FEDERAL REVENUE ACTS DESIGNATE WHAT INTERESTS OR RIGHTS SO CREATED SHALL BE TAXED, BOTH BY HOLDING ERRONEOUSLY THAT SUCH RIGHTS OVER DID SO EXIST AND BY HOLDING THAT, EVEN IF SUCH RIGHTS OVER DID NOT SO EXIST, THE PRINCIPLE OF UNIFORMITY OF TAXATION OPERATED TO ESTABLISH THEM FOR FEDERAL ESTATE TAX PURPOSES.

The Circuit Court of Appeals' erroneous holding that rights over did exist under California law at the time of decedent's death led it into the first step along its path

of a failure to give proper effect to the decisions of the United States Supreme Court that State law creates legal interests and rights and the federal revenue acts designate what interests or rights so created shall be taxed.

In *Morgan v. Commissioner*,[26] this Court said:

> "State law *creates* legal interests and rights. The federal revenue acts designate what interests or rights, *so created* shall be taxed."

Having erroneously decided that it was dealing with interests and rights *already created* under State law, the

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[26]309 U.S. 78 at 80-81, 60 S.Ct. 424 at 426, 84 L.Ed. 585 at 588 (1940). Accord: *Crooks v. Harrelson* (1930), 282 U.S. 55 at 59, 51 S.Ct. 49 at 50, 75 L.Ed. 156 at 175 ("• • • if the value of the interest of the decedent • • • is not subject, under the laws of Missouri, to the expenses of administration, it forms no part of the gross estate for the purpose of the federal estate tax"); *Poe v. Seaborn* (1930), 282 U.S. 101 at 117, 51 S. Ct. 58 at 61, 75 L.Ed. 239 at 247 ("• • • the earnings are *never* the property of the husband, but that of the community"); *Lang v. Commissioner* (1937), 304 U.S. 264, 58 S.Ct. 880, 82 L.Ed. 1331; *Helvering v. Stuart* (1942), 317 U.S. 154 at 162, 63 S.Ct. 140 at 144-45, 87 L.Ed. 154 at 159 ("Congress has selected an event • • • whether that event may or may not occur depends upon • • • state law"). See also *Davies Warehouse Co. v. Bowles* (1943), 321 U.S. 144 at 155, 64 S.Ct. 474 at 480-81, 88 L.Ed. 635 at 643; *Fernandez v. Wiener* (1945), ... U.S. ....., 66 S.Ct. 178 at 190-91, 90 L.Ed. 147 at 162 (Mr. Justice Douglas, concurring: "The character and extent of property interests under local law often determine the reach of federal tax statutes.")

Accord: *Ardenghi v. Helvering* (CCA 2d, 1938), 100 F.(2d) 406, cert. den. 307 U.S. 622, 59 S.Ct. 793, 83 L.Ed. 1501; *Metropolitan Life Ins. Co. v. United States* (CCA 6th, 1939), 107 F. (2d) 311 at 313, cert. den. 310 U.S. 630, 60 S.Ct. 987, 84 L.Ed. 1400; *Legg's Estate v. Commissioner* (CCA 4th, 1940), 114 F. (2d) 760 at 763; *Foy v. Rothensies* (CCA 3rd, 1940), 115 F.(2d) 42 at 44; *Brown v. Commissioner* (CCA 7th, 1941), 119 F.(2d) 983; *Webster v. Commissioner* (CCA 5th, 1941), 120 F.(2d) 514; *Gammons v. Hassett* (CCA 1st, 1941), 121 F.(2d) 229 at 231, cert. den. 314 U.S. 673, 62 S. Ct. 136, 86 L.Ed. 539.

Circuit Court of Appeals applied not the foregoing rule but, the antithetical doctrine of this Court that[27]

> "If it is found in a given case that an interest or right created by local law was the object intended to be taxed, the federal law must prevail no matter what *name* is given *to the interest or right* by state law * * *"

It thus concluded that

> " * * * The revenue acts are intended to have a uniform application and to bring into the gross estate what is fundamentally the same in all states, not colored by local characterization * * *" (R. 78.)

The inapplicability of this latter doctrine is immediately apparent inasmuch as rights over were not, pursuant to California law, in existence at decedent's death. Thus, the failure of the Circuit Court of Appeals to recognize and apply local law [28] infected its subsequent choice of rulings as established by the United States Supreme Court, and resulted in a failure to give a proper effect to those rulings.

In the development of its reasoning, the Circuit Court of Appeals went further and indicated also that, even assuming the nonexistence of rights over at the time of

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[27]Ibid., *Morgan v. Commissioner.* Accord, *Burnet v. Harmel* (1932), 287 U.S. 103, 53 S.Ct. 74, 77 L.Ed. 199; *Heiner v. Mellon* (1937), 304 U.S. 271, 58 S.Ct. 926, 82 L.Ed. 1337; *Lyeth v. Hooey* (1938), 305 U.S. 188, 59 S.Ct. 155, 83 L.Ed. 119; *United States v. Pelzer* (1940), 312 U.S. 399, 61 S.Ct. 659, 85 L.Ed. 913; *Estate of Rogers v. Commissioner* (1942), 320 U.S. 410 at 414, 64 S.Ct. 172 at 174, 88 L.Ed. 134 at 137; cf. *Lusthaus v. Commissioner* (U.S. S.Ct., 1946), 14 L.W. 4203 at 4204, note 1 (Mr. Justice Reed, dissenting).

[28]*Supra*, pages 13-23.

decedent's death, it would still not recognize the distinction between the creation of such rights, and their taxability thereafter. Thus it said:

> "It is *of no importance* whether they are new rights independent of the original contract or old rights, emerging from inchoate rights lying dormant." (R. 78.)

Contrary to this, petitioners contend that it is of the *utmost importance* whether rights over are rights which are *created only when the guarantor actually pays*, or whether they are rights *existing prior to that time*. If no such rights were in existence at decedent's death, nothing therefor should be included in her estate since no rights are within the reach of the federal estate tax[29]. The distinction ignored was the very one the Circuit Court of Appeals was required to draw.[30]

The uniformity of application desirable under the federal revenue acts is not meant to obliterate the differences of local law when the existence or non-existence of a property interest is involved.[31] Such uniformity is satisfied whenever an act operates with the same force and effect in every place where *the subject* of it is found.[32]

However indistinct may be the line between those situations in which local law does and those situations in which it does not control the meaning of statutory language in the federal revenue acts, it appears clear that whether a property interest has or has not, as viewed by

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[29]*Supra*, note 7.

[30]*Supra*, notes 26, 27.

[31]*Poe v. Seaborn*, *supra*, note 26, at 117-18, 61, 247, and other cases there cited.

[32]*Fernandez v. Wiener*, *supra*, note 26, at ....., 118, 159.

local law, come into existence in some form for some or all of the purposes of ownership is determinative of whether that interest is within the reach of the statutes involved.[33]

Petitioners submit that the Circuit Court of Appeals failed to give proper effect to this Court's decisions on the applicability of state law to federal revenue acts by erroneously determining that rights over were already created under California law at decedent's death so that the only problem seemed to be what such rights were called, and by holding further that whether such rights did or did not exist at decedent's death was a matter "of no importance" because of the requirements for uniform application of the revenue acts.

III.

EVEN ASSUMING THAT SUCH RIGHTS OVER DID SO EXIST, THE CIRCUIT COURT OF APPEALS ERRED IN FAILING TO VALUE THEM BY THE FORMULA ESTABLISHED IN THE INTERNAL REVENUE CODE AND THE REGULATIONS THEREUNDER. THERE IS A CONFLICT IN THE DECISIONS AS TO THE METHOD OF VALUING SUCH RIGHTS OVER AND THE METHOD FOLLOWED BY THE CIRCUIT COURT OF APPEALS WAS NOT THE PROPER ONE.

Petitioners sought to introduce evidence in the Tax Court bearing on the fair market value of the rights over, assuming such rights to have existed at decedent's death.

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[33]See Cahn, "Local Law in Federal Taxation", 52 Y.L.J. 799 at 804 "• • • Diversities of local law are entitled to respect where they bear upon the ownership, use or transfer of property • • •"; Paul, SELECTED STUDIES IN TAXATION, *op. cit.*, pp. 23-28; Barton, "The Effect of State Laws on Federal Tax Laws" (1932), 10 Tax Mag. 11; Note (1941) 55 H.L.R. 255-64.

(R. 41-49.) The evidence was excluded by the Tax Court, and the Circuit Court of Appeals in justifying the exclusion said that

> "No difficulty is encountered in fixing the value of rights over. It is conceded that the company and the co-guarantor were, at the time of decedent's death, solvent and able to pay the claims and so continued up to the time of the hearing in the tax court * * * When, as here, * * * the company was fully able to pay and discharge the debt, there is no reason to encumber the record by the introduction of opinion evidence as to the value. Such evidence would have been of no assistance to the tax court." (R. 78-79.)

Petitioners regard this as erroneous for it substitutes a test of "solvency" for the "fair market value" formula which is established in the Internal Revenue Code and the Regulations thereunder.

Section 811[34] of the Internal Revenue Code provides in part that

> "The value of the gross estate of the decedent shall be determined by including the *value* at the time of his death of all property * * *"

Section 81.10[35] of Treasury Regulations 105 furnishes an appropriate interpretative regulation of this general language,[36] providing in part that

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[34] *Supra*, note 7.

[35] Reg. 105 (1942), Sec. 81.10 (a).

[36] See *Morrissey v. Commissioner* (1935), 296 U.S. 344 at 354, 56 S.Ct. 289 at 294, 80 L.Ed. 263 at 269; *Helvering v. Reynolds Co.* (1938), 306 U.S. 110 at 114, 59 S.Ct. 423 at 425, 83 L.Ed. 536 at 540.

"(a) *General*—The value of every item of property includible in the gross estate is the *fair market value* thereof at the time of decedent's death • • •"

This "fair market value" formula, applicable in evaluating interests such as rights over, [37] found its first expression in the Treasury Department Regulations relating to the Revenue Act of 1924.[38] From 1924 until the present, the formula has been retained uniformly and consistently in the various Treasury Regulations.[39] It remained undisturbed by Congress, both in the re-enactment[40] in 1926 and again in 1939 of the applicable valuation provisions of Section 811 and in the amendments adopted at other

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[37]Specific valuation formulas are established by Section 81.10 of T.R. 105 for numerous classes of property, none of which includes rights over. Accordingly, Section 81.10(h) is applicable to such rights: "(h) *Other Property:* Any property not specifically treated in this section should be valued in accordance with the rule laid down in sub-section (a) hereof • • •" See also —2 Paul, FEDERAL ESTATE AND GIFT TAXATION § 18.05.

[38]Reg. 68 (1924), Art. 13, "Valuations—(1) General.—The value of all property includible in the gross estate is the *fair market value* thereof at the time of the decedent's death • • •". Even earlier, the formula had been described in the Regulations as one based on "market or sale value". See Reg. 63 (1922), Art. 13, "Value—Property of the decedent should be returned at its *market or sale value* at the time of the decedent's death • • •"

[39]Reg. 68 (1924), Art. 13 (1); Reg. 70 (1929), Art. 13 (1); Reg. 80 (1934), Art. 13 (1); Reg. 80 (1937), Art. 10 (a); Reg. 105 (1942), Sec. 81.10(a).

[40]See R.A. 1926 (Sec. 302(a)), 44 (Pt. 1) Stats. 835 (69th Cong., 1925-26); I.R.C. 1939 (Ch. 3, Sec. 811(a)), 53 (Pt. 1) Stats. 120 (76th Cong. 1st Sess., 1939). The same valuation language has remained from the earliest days of the Estate Tax Act. See R.A. 1916 (Sec. 202(a)), 39 (Pt. 1) Stats. 777 (64th Cong., 1915-17); R.A. 1918 (Sec. 402 (a)), 40 (Pt. 1) Stats. 1097 (65th Cong., 1917-19); R.A. 1921 (Sec. 402(a)), 42 (Pt. 1) Stats. 278 (67th Cong., 1921-23); and R.A. 1924 (Sec. 302(a)), 43 (Pt. 1) Stats. 304 (68th Cong., 1923-25).

times[41] to the Estate Tax law. The formula may thus be considered settled administrative practice[42] to which the force and effect of Congressional approval has attached.[43]

What is required in the application of the "fair market value" formula to rights over? The further delineation of the term has likewise been fixed by uniform administrative regulations[44] over the years. Section 81.10 of Treasury Regulations 105 establishes it as

> "• • • *the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell* • • •"

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[41]R.A. 1928, 45 (Pt. 1) Stats. 862-3 (70th Cong., 1927-29); R.A. 1932, 47 (Pt. 1) Stats. 243-84 (72nd Cong., 1931-33); R.A. 1934, 48 (Pt. 1) Stats. 792-55 (73rd Cong., 1933-34); R.A. 1935, 49 (Pt. 1) Stats. 1021-23 (74th Cong., 1935-36); R.A. 1938, 52 Stats. 564-83 (75th Cong., 3rd Sess., 1938); F.R.A. 1940, 54 Stats. 521, 758 (76th Cong., 3rd Sess., 1939-41); S.R.A. 1941, 55 (Pt. 1) Stats. 704 (77th Cong., 1st Sess., 1941-42); R.A. 1942, 56 (Pt. 1) Stats. 941-50 (77th Cong., 2d Sess., 1942); 58 (Pt. 1) Stats. 71, 74 (78th Cong., 2d Sess., 1944).

[42]See *Cecil H. Gamble*, 33 BTA 94, 99, aff'd. 101 F.(2d) 565 (CCA 6th, 1939), cert. den. 306 U.S. 664 (1939), in which when a distinction between "value" and "fair market value" was sought to be drawn in the Estate Tax Act, the Board said: "• • • However, the soundness of such position is, at least, doubtful, in view of the consistent re-enactment of prior similar provisions, all containing the word 'value' and the substantially similar construing regulations • • • Both the courts and this Board, under similar circumstances, have apparently interpreted the term as meaning 'fair market value' • • •" See also, 2 Paul, FEDERAL ESTATE AND GIFT TAXATION, p. 1214, § 18.02.

[43]*United States v. Seattle First National Bank* (1944), 231 U.S. 583, 64 S.Ct. 713, 88 L.Ed. 944; *Helvering v. Reynolds Co.* and *Morrissey v. Commissioner, supra*, note 36. Cf. *Helvering v. Reynolds* (1940), 313 U.S. 428, 61 S.Ct. 971, 85 L.Ed. 1438; *Helvering v. Hallock* (1939), 309 U.S. 106, 60 S.Ct. 444, 84 L.Ed. 604; *Helvering v. Wilshire Oil Co.* (1939), 308 U.S. 90, 60 S.Ct. 18, 84 L.Ed. 101.

[44]*Supra*, note 39.

Hypothetical though the willing buyer and seller may be,[45] the actualities which would exist upon any such sale cannot be brushed aside. The time of sale is by postulate the time of decedent's death, and what *might* happen *subsequent thereto* is of no concern.[46] The decedent not having paid the guaranty, it is completely uncertain that decedent's estate will ever recover one cent if and when it pays. For if and when the guaranty is paid by the decedent's estate, it is completely uncertain whether, at that time, those liable over will be either solvent, or, if individuals, alive.[47] Moreover, in California, the right over which one receives upon payment of the obligation may be only the right to a law suit. Thus in *Jack v. Wong Shee,*[48] the Court said:

> "• • • It is true that under the law as it exists today *the right of subrogation is not one which a party may assert by his own action, but is one which may be asserted only in a civil action.* (*Offer v. Superior Court,* 194 Cal. 114, 117; 23 Cal. Jur. 945; 25 R.C.L. 1391, sec. 794) • • •"

All the defenses which may exist between the maker and the payee challenge the guarantor's ultimate collection on his law suit. The costs and attorney's fees which may be involved are also uncertain but, nonetheless, factors which cannot be ignored.

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[45]The existence of a willing buyer and a willing seller are assumed, whether they actually exist or not. *Bank of California v. Commissioner* (CCA 9th, 1943), 133 F.(2d) 428.

[46]*Supra,* note 7. See *Ithaca Trust Co. v. United States* (1929), 279 U.S. 151, 49 S.Ct. 291, 73 L.Ed. 647.

[47]If a California guarantor has not paid, he cannot establish a claim against the estate of a co-maker. See *Jackson v. Lacy, supra,* note 25.

[48]33 C.A.(2d) 402 at 441, 92 P.(2d) 449 at 453 (1939).

These then are the uncertainties which the hypothetical willing buyer and seller must ponder in arriving at "fair market value" of rights over. These are the uncertainties which a Court in giving context to "fair market value" must weigh. These are the uncertainties which caused petitioners to seek to introduce expert opinion on the value of the alleged rights over. To assume that the sole fact of solvency of the maker and the co-guarantor at the time of the guarantor's death is sufficient to make such rights over worth one hundred cents on the dollar is to ignore completely the very uncertainties which find expression only through the "fair market value" formula.

There is a conflict in the decisions of the various Circuit Courts of Appeals on the question whether the "fair market value" formula requires more in the evaluation of rights over than the determination of the solvency or insolvency, at the time of the guarantor's death, of the party normally ultimately liable.[49]

The state of the decisions adopting and applying the "solvency" test, as did the Circuit Court of Appeals below, is summarized in *Commissioner v. Wragg*[50] wherein it is said

> "Thus when it has appeared that the decedent's right over against the primary obligor was worth its face value, no deduction has been allowed for a secondary liability (Estate of Lay, 40 B.T.A., 522; Hartford Nat. Bank & Trust Co. v. Smith, D.C. Conn.,

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[49]The opposing viewpoints are exemplified in *Commissioner v. Wragg* (CCA 1st, 1944), 141 F.(2d) 638, and *Guggenheim v. Helvering* (CCA 2d, 1941), 117 F.(2d) 469, cert. den. 314 U.S. 612, 62 S.C. 66, 86 L.Ed. 499.

[50]*Supra*, note 49.

54 F. Supp. 579; see also Parrott v. Commissioner, 9 Cir., 30 F. 2d. 792, certiorari denied 279 U.S. 870, 49 S. Ct. 512, 73 L. Ed. 1007; Buck v. Helvering, 9 Cir., 73 F. 2d 760); but when it has appeared that the right over was valueless, a deduction for it has been allowed. United States v. Mitchell, 7 Cir., 74 F. 2d 571; Commissioner v. Porter, 92 F. 2d. 426; Carney v. Benz, 1 Cir., 90 F. 2d 747, 113 A.L.R. 365; Dodge v. Gagne, D.C., 23 F. Supp. 729. And, when it has appeared that the right was worth something but not its face value, a deduction has been allowed to the extent of the amount which actually had to be paid and could not be recovered from the primary obligor by the estate. McCoy v. Rasquin, 2 Cir., 102 F. 2d 434; Eckart v. Commissioner, 33 B.T.A. 426, 440; Estate of Borland, 38 B.T.A. 598."

The categorization here adopted is based quite apparently on the criteria of "solvency", "insolvency", and, if the latter, "insolvency to what extent". In fact, so insistent on this approach was the Court in the *Wragg* case that it implied a finding of insolvency in order to sustain the Tax Court's action in permitting the deduction without offsetting the face value of the rights over, despite the absence of such a finding of fact by the Tax Court.[51]

On the other hand, a more realistic approach to the valuation problem, and one which rejects as inadequate the test of "solvency", is to be found in *Guggenheim v.*

[51] *Supra*, note 50, at 640: "Thus we think that the Tax Court must have concluded, but merely failed to state, that the right of the estate over against the son was valueless, and, this being so, we see no point in remanding the case for a definite finding to that effect."

Helvering.[52] There, Judge Learned Hand, writing for the Second Circuit Court of Appeals, reversed the Board of Tax Appeal's finding of valuation for a failure to take into account the uncertainties connected with guaranty obligations remaining open at the date of death. He said:[53]

> "* * * there were the existing commitments of the most serious nature, for * * * the 'Old Firm' had *guaranteed* $12,000,000 of the Anglo-Chilean accounts and it had advanced upon the share of the decedent's son some $3,500,000 *for which his estate stood guarantor. All these liabilities the Board refused to consider because at the values it had found as of September 28, 1930, nothing would be due under them. We cannot agree* * * * It is true, as the Board said, that the effect of these was uncertain and could not be accurately appraised. * * * In appraising property of this kind * * * it is impossible to avoid some measure of speculation * * * a judicial duty which is inherently subject to such shortcomings must not stop half-way * * * situations again and again present themselves where * * * a tribunal will make the best reckoning that the facts admit though fully conscious of its infirmities * * *"

Again, in speaking of collateral pledged with a guaranty of the decedent, Judge Hand said:[54]

> "* * * it was improper to include the collateral as though it had not been subject to the pledge. When a decedent has pledged part of his estate upon

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[52] 117 F.(2d) 469 at 473-75 (CCA 2d, 1941), cert. den. 314 U.S. 612, 62 S.C. 66, 86 L.Ed. 499 (1941).

[53] *Id.*, at 473-75.

[54] *Ibid.*

> a debt of his own it is reasonable to include it at its full value because he gets a deduction for the debt, *but when he pledges it for the debt of another—even a debt which he has guaranteed, that is not so* • • • The problem is the same in kind as in the case of the decedent's interest in the 'Old Firm' itself; *and it was necessary to make some allowance for the same chances that infected the decedent's interests in the assets of the 'Old Firm.' As to this item there must therefore be a reappraisal.''*

Reference to the opinion in the *Guggenheim* case when it was before the Board of Tax Appeals[55] indicates quite clearly that the Board had proceeded below using the test of "solvency" as a substitute for or the equivalent of "fair market value" in its evaluation of the guaranty obligations and the rights over of the "Old Firm". Thus, the Board said:[56]

> *"In view of the uncertainty as of the date of death that the contingent liability* of the old firm as a guarantor would ever ripen into an actual liability, and in view of the fact that it never did become an actual liability of the old firm, we are of the opinion that *there is no justification for reducing the value of decedent's interest in the old firm by his proportionate share of what the firm might have been compelled to pay.''*

And, with respect to the collateral pledged with decedent's guaranty, the Board in refusing the deduction said:[57]

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[55]*Estate of Daniel Guggenheim* (1939), 39 B.T.A. 251.
[56]*Id.*, at 305.
[57]*Id.*, at 315-17.

"* * * *it was not known at the date of death, or even at the time of the hearing, whether the decedent's estate would, or would not, have to make any payments in connection with his guaranty* of any final debit balance in Harry's account. Even though there was a substantial debt balance in the account at the date of the decedent's death * * * *it was secured by collateral, in addition to the $79,900, having a value of more than four and one-half million dollars.* Obviously, if such collateral is sufficient to take care of the final debit balance, the $79,900 will not be required for that purpose.

"*It cannot be presumed, in the absence of any evidence showing it to be a fact, that there will be a final debt balance in the account when all of the enterprises in which Harry has an interest are terminated. Petitioner's contention that the item did not represent anything of value to the decedent on the date of death cannot be sustained.* The $79,900 was properly included by the respondent in decedent's gross estate."

These were the principles of valuation with which Judge Hand, speaking for the Circuit Court of Appeals in the *Guggenheim* case, said, "We cannot agree",[58] and reversed the Board of Tax Appeals.

Petitioners submit that the "fair market value" formula established by the Internal Revenue Code and the Regulations thereunder for valuing rights over in situations where an open guaranty exists as of the time of death is not satisfied by an application of a test of "solvency" at that time of the party normally ultimately

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[58] *Supra*, page 34.

liable; that the *Guggenheim* case, rather than the *Wragg* case or the decision below is the proper view of the subject; and that accordingly it was error for the Circuit Court of Appeals to value the assumed rights over in the full amount of the guaranty claim simply because the corporate maker and the co-guarantor were solvent at the time.

IV.

THE CIRCUIT COURT OF APPEALS ERRED IN HOLDING THAT "AN ABSURDITY CLEARLY APPEARS" IN PETITIONERS' CONTENTIONS BECAUSE THE ESTATES OF NUMEROUS CO-GUARANTORS MIGHT EACH CLAIM A LIKE DEDUCTION.

The conclusion of the Circuit Court of Appeals that "an absurdity clearly appears" in the contention that decedent's estate is entitled to a deduction for the bank's claim because the estate of numerous co-guarantors might each claim a like deduction is not only a "parade of the horribles" but also "judicial legislation" where none is warranted.

The Circuit Court of Appeal's basic difficulty appears to be that it conceives as "absurd" a situation in which a decedent's estate is entitled to a deduction on a guaranty claim which may never be paid. This quite overlooks that it has been well settled in other situations that the plain language of the Estate Tax law was not to be disregarded for this reason.

In *Commissioner v. Strauss*,[59] the claims involved were neither presented, allowed nor paid. Yet the Court said:

> "The *statute* governs in either case. Sec. 303 (a) (1) Revenue Act of 1926 (26 USCA Sec. 1095 (a) (1)) *does not require* the allowance of the debt by the court or *its payment by the estate* in order that it may be deducted from the gross estate * * *"

It is, further, settled law that the right to deduct a claim derives from the statute as a matter of legislative grace and is not based on equitable considerations or upon general principles of law and does not depend upon any discretion vested in the Commissioner.[60]

The Circuit Court of Appeals may have thought that permitting a claim to be deducted which might never be paid was "unwise", but questions of such wisdom are for the legislative, not the judicial, province. In 50 *Am. Jur.*, p. 391, Sec. 380, it is well said

> "*Unwise Results.* It is not the function of a Court in the interpretation of statutes to set forth what the act under consideration should provide, or to vindicate the wisdom of the law. The mere fact that the statute leads to unwise results, is not sufficient to justify the Court in rejecting the plain meaning of unambiguous words, or in giving to stat-

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[59]77 F.(2d) 401 at 405 (CCA 7th, 1935); see also *Commissioner v. Windrow* (CCA 5th, 1937), 89 F.(2d) 69 at 71; *Helvering v. Northwestern Nat. Bank, etc.* (CCA 8th, 1937), 89 F.(2d) 553 at 556; *Commissioner v. Lyne* (CCA 1st, 1937), 90 F.(2d) 745 at 746; *Helvering v. O'Donnell* (CCA 2d, 1938), 94 F.(2d) 852 at 853; *Commissioner v. Hallock* (CCA 6th, 1939), 102 F.(2d) 1 at 5.

[60]*Porter v. Commissioner* (1933), 288 U.S. 436 at 441, 53 S.Ct. 451 at 454, 77 L.Ed. 880 at 883; *Deputy v. DuPont* (1940), 308 U.S. 488, 60 S.Ct. 363, 84 L.Ed. 416. See also 1 Paul, FEDERAL ESTATE AND GIFT TAXATION, p. 573, Sec. 11.02.

utes a meaning of which its language is not susceptible. An omission or failure to provide for contingencies, which it may seem wise to have provided for specifically does not justify any judicial addition to the language of the statute. To the contrary, it is the duty of the Courts to interpret a statute as they find it without reference to whether its provisions are wise or unwise, necessary or unnecessary, appropriate or inappropriate, or well or ill conceived. If a change in the law is needed, it is to be effected by the legislature and not by judicial action in the guise of interpretation. However, the wisdom of a law as interpreted under the rules of construction, may operate to bolster such interpretation. *It has been declared, moreover, that the courts in construing a statute, should hesitate before ascribing a want or wisdom to the legislature in the enactment thereof.*"

CASES BELIEVED TO SUSTAIN THE JURISDICTION.

1. That an important question of California law (whether decedent had rights over at the time of her death) was incorrectly decided by the Circuit Court of Appeals.

Relied on by Circuit Court of Appeals.

Parrott v. Commissioner, 30 F. (2d) 792 (CCA 9th, 1929) Cert den. 279 U.S. 870, 49 S. Ct. 512, 73 L. Ed. 1007.

Relied on by petitioners.

Sherwood v. Dunbar (1855) 6 Cal. 53;

Chipman v. Morril (1862) 20 Cal. 130;

Richter v. Henningsam (1895) 110 Cal. 530 at 531, 42 Pac. 1077 at 1079;

Bunker v. Osborn (1901) 132 Cal. 480, 64 Pac. 853;

Yule v. Bishop, (1901) 133 Cal. 574, 65 Pac. 1094;

Lowenthal v. Coonan (1902) 135 Cal. 381, 67 Pac. 324;

Davies v. Torrance (1922) 188 Cal. 179, 204 Pac. 820;

W. H. Marston Co. v. Fisheries Co. (1927) 201 Cal. 715 at 724, 258 Pac. 933 at 936;

M. K. McCann Co. v. Denny (1928) 205 Cal. 147 at 152, 270 Pac. 190 at 192;

Crystal v. Hutton (1905) 1 Cal. App. 251, 81 Pac. 1115;

Wills v. Woolner (1913) 21 Cal. App. 528, 132 Pac. 283;

Huey v. Patterson (1918) 37 Cal. App. 335 at 341-42, 174 Pac. 939 at 942;

Arp. v. Blake (1923) 63 Cal. App. 362 at 366, 218 Pac. 773 at 775;

Harris v. King (1931) 113 Cal. App. 357 at 362-64, 298 Pac. 100 at 102-03;

Jackson v. Lacy (1940) 37 C.A. (2d) 551 at 559-60, 100 Pac. (2d) 313 at 317;

Pacific Freight Lines v. Pioneer Express Co. (1940) 39 C.A. (2d) 609, 103 Pac. (2d) 1056.

2. That proper effect was not given to United States Supreme Court decisions that State law creates legal interests and rights and the federal revenue acts designate what interests or rights so created shall be taxed.

Crooks v. Harrelson (1930) 282 U.S. 55 at 59, 51 S. Ct. 49 at 50, 75 L. Ed. 156 at 175;

Poe v. Seaborn (1930) 282 U.S. 101 at 117, 51 S. Ct. 58 at 61, 75 L. Ed. 239 at 247;

Lang v. Commissioner (1937) 304 U.S. 264, 58 S. Ct. 880, 72 L. Ed. 1331;

Morgan v. Commissioner (1940) 309 U.S. 78 at 80-81, 60 S. Ct. 424 at 426, 84 L. Ed. 585 at 588;

Helvering v. Stuart (1942) 317 U.S. 154 at 162, 63 S. Ct. 140 at 144-45, 87 L. Ed. 154 at 159;

Fernandez v. Wiener (1945) —— U.S. ——, 66 S. Ct. 178 at 190-91, 90 L. Ed. 147 at 162.

3. That there is a conflict in the decisions of the Circuit Court of Appeals as to how rights over shall be valued for inclusion in the gross estate.

Commissioner v. Wragg, 141 F. (2d) 638 (CCA 1st, 1944);

DuVal v. Commissioner, 152 F. (2d) 103 (CCA 9th, 145) (the instant case);

Guggenheim v. Helvering, 117 F. (2d) 469 (CCA (2d) 1941) Cert. den. 314 U.S. 612, 62 S. Ct. 66, 86 L. Ed. 499.

CONCLUSION.

However desirable it may be that California law should, like that of other states, recognize rights over in a guarantor prior to payment of the guaranty obligation, the point remains that it does not do so.

The California view on this local-law question of when property rights are created is entitled to respect, as both Congress and the Supreme Court have recognized.

There was either nothing to be included in decedent's estate for rights over, or, if something, only its fair market value which could not under the circumstances have been the full amount of the guaranty claim.

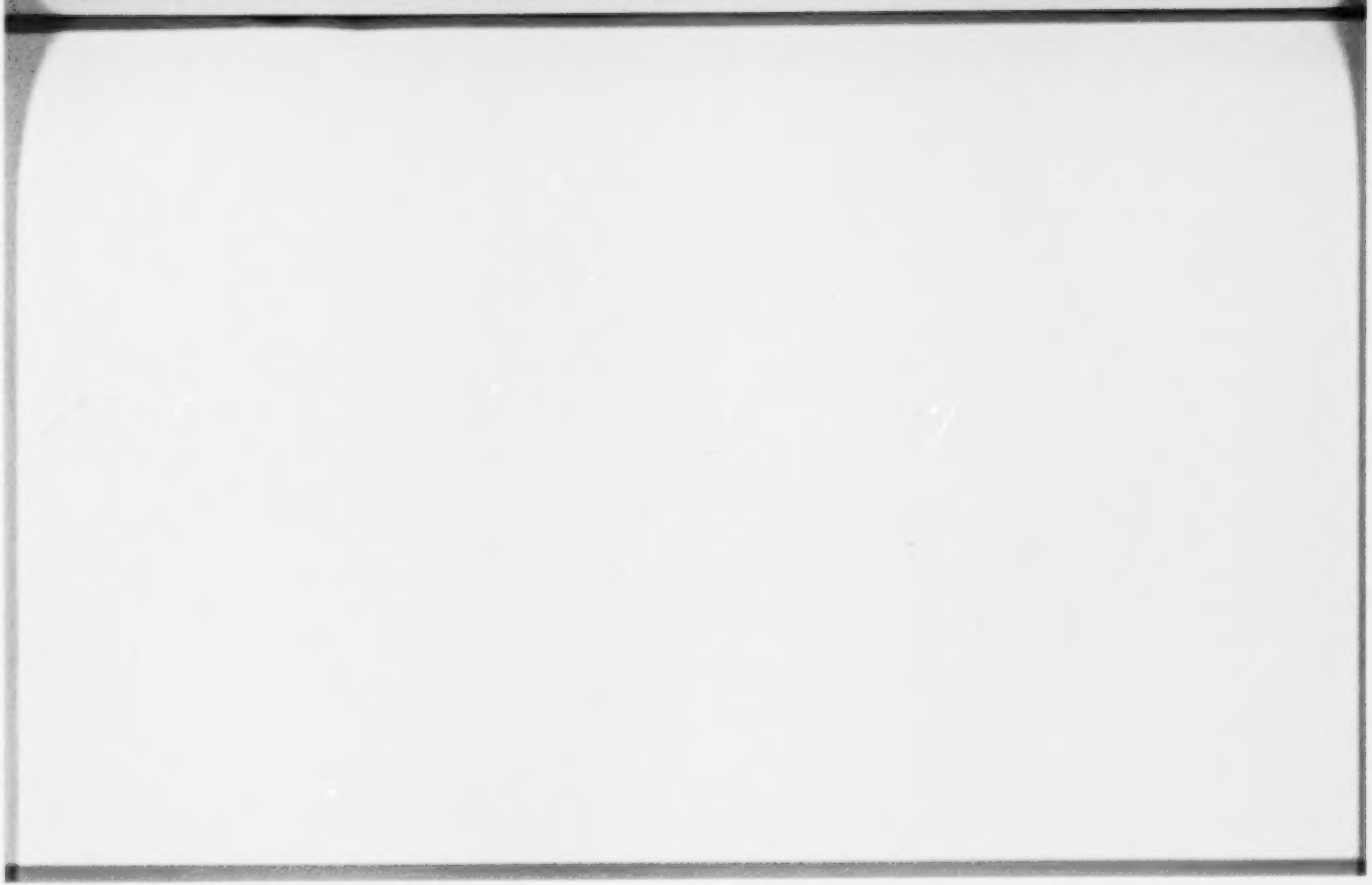
In either event, the disallowance by the Commissioner of the deduction taken by the executors for the bank's claim against the estate was not proper and should not be sustained.

Dated, Oakland, California,
March 18, 1946.

Respectfully submitted,
CHARLES A. BEARDSLEY,
Attorney for Petitioners.

FITZGERALD, ABBOTT & BEARDSLEY,
Of Counsel.

(Appendix Follows.)



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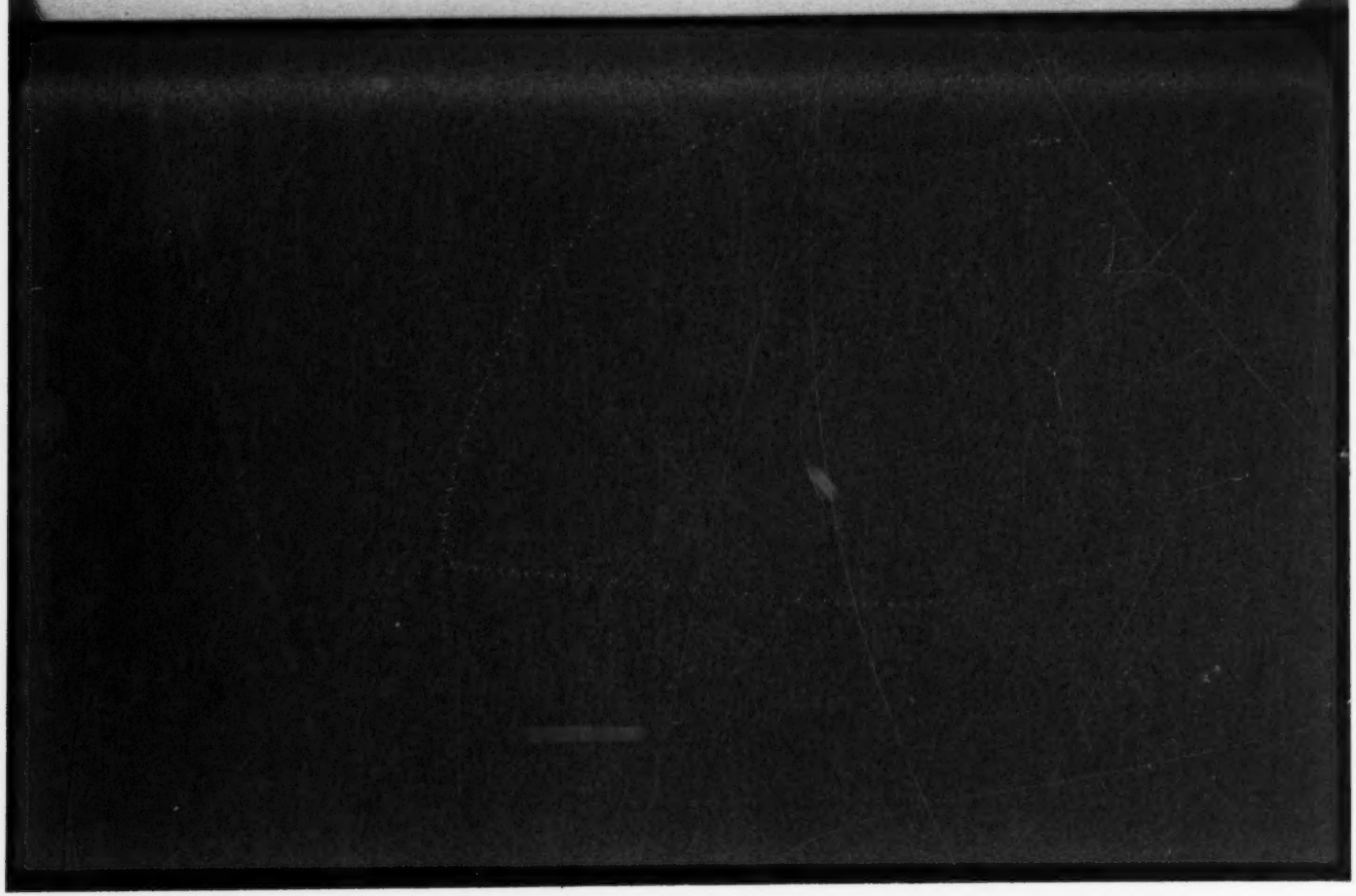

Appendix

(Pertinent statutes, federal and state, and regulations)

Federal Statutes. (I. R. C. (1939) Ch. 3, Estate Tax, 53 (Pt. 1) Stats. 122 (76th Cong., 1st. Sess., 1939)

"The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated * * *

(a) * * * to the extent of the interest therein of the decedent at the time of his death * * *". Sec. 811.

"For the purpose of this tax, the value of the net estate shall be determined * * * by deducting from the value of the gross estate * * *

(b) * * * amounts * * *

(3) for claims against the estate,

* * * * * * *

as are allowed by the laws of the jurisdiction * * * under which the estate is being administered * * *" Sec. 812 (b) (3).

California Statutes (Deering 1941)

"*Claims on Contract: Funeral expenses.* All claims arising upon contract, whether they are due, not due, or contingent, * * * must be filed or presented within the time limited in the notice * * * and any claim not so filed or presented is barred forever." Section 707, Probate Code.

"*Status of allowed claim.* Every claim allowed by the executor or administrator and approved by the judge shall be ranked among the acknowledged debts of the estate, to be paid in due course of administration; but the validity thereof may be contested by any person in interest, at any time prior to the settlement of the account of the executor or administrator in which it is first reported as an allowed and approved claim * * *". Section 713, Probate Code.

Contribution between joint parties. A party to a joint, or joint and several obligation, who satisfies more than his share of the claim against all, may require a proportionate contribution from all the parties joined with him." Section 1432, Civil Code.

"*Necessity for consideration.* Where a suretyship obligation is entered into at the same time with the original obligation, or with the acceptance of the latter by the creditor, and forms with that obligation a part of the consideration to him, no other consideration need exist. In all other cases there must be a consideration distinct from that of the original obligation." Section 2792, Civil Code.

"*Construction of suretyship obligation.* A suretyship obligation is to be deemed unconditional unless its terms impart some condition precedent to the liability of the surety." Section 2806, Civil Code.

Note. Prior to amendment in 1939, the above two sections used the word "guaranty" instead of "suretyship". The distinction between sureties and guarantors was abolished in California in 1939. (Section 2787, Civil Code.)

Federal Regulations (Reg. 105 (1942))

"(a) *General.* The value of every item of property includible in the gross estate is the fair market value thereof at the time of decedent's death * * * fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell * * *

* * * * * * *

(h) *Other Property.* Any property not specifically treated in this section should be valued in accordance with the rule laid down in sub-section (a) hereof * * * Sec. 81.10 (a) at (b).